

CALIFORNIA FRANCHISE TAX BOARD

Legal Ruling No. 052

June 27, 1958

LITIGATION SETTLEMENT: NATURE OF INCOME

Syllabus:

For tax purposes, the amounts received in settlement of litigation are classified by the nature and basis of the action settled.

In 1946, taxpayer listed certain real estate, acquired in 1936, with real estate agents who purported to sell it for \$10,000. Taxpayer learned they had purchased the property themselves and resold it for \$23,000. Taxpayer retained legal counsel to recover the additional amount, alleging fraud. In 1948 the matter was settled without suit and taxpayer reported the amount less attorney's fees as capital gains. Advice is requested as to whether the amount was properly reportable as a capital gain.

The classification for tax purposes of amounts received in settlement of litigation is determined by the nature and basis of the action settled. When a taxpayer sells capital assets and subsequently recovers from the buyer an additional amount in an action for fraud, the additional amount is taxable as a capital gain because it is in the nature of additional consideration for the sale. Therefore, the additional amount recovered by way of settlement is properly treated as a capital gain.